

General Information Letter: Response to questions regarding nexus from provision of training services within Illinois.

January 21, 1998

Dear:

This is in response to your letter received on January 7, 1998, in which you requested information regarding activities that may create nexus with this State. Illinois Department of Revenue (the "Department") rules require that the Department issue two types of letter rulings, private letter rulings ("PLR") and general information letters ("GIL"). PLRs are issued by the Department in response to specific taxpayer inquiries concerning the application of a tax statute or rule to a particular fact situation. A PLR is binding on the Department, but only as to the taxpayer who is the subject of the request for ruling and only to the extent the facts recited in the PLR are correct and complete. GILs do not constitute statements of agency policy that apply, interpret or prescribe the tax law and are not binding on the Department, but PLRs are binding on the Department. For your general information we have enclosed a copy of 2 Ill. Adm. Code Part 1200 regarding rulings and other information issued by the Department.

Although you have not specifically requested either type of ruling, the nature of your questions and the information you provided require that we respond with a GIL.

In your letter you state the following:

Our accounting firm, xxxx & xxxxxxxx, xx has been retained to prepare the federal corporate and the required state corporate tax returns for a Pennsylvania based corporation. There are a few questions for which we need clarification regarding the taxability of income generated in various states. The following scenario will outline the activity of this corporation and hopefully it can be determined as to whether nexus exists so that we can correctly identify the amount of income to be reported to your state.

Corporation A is a Pennsylvania C corporation. The principal and only office is located in Pennsylvania. Corporation A is a service corporation which provides "on site" training and computer consulting services to various companies throughout the United States. The majority of the assignments are obtained through the software company (Corporation B) which originally sold the software to these various companies. Corporation A therefore performs the service in various states, but does not bill the companies in those states. Corporation A receives its revenue from billings to the software company (Corporation B). In other words, the software company (Corporation B) subcontracts Corporation A to perform any training services necessary for clients who have purchased software from Corporation B. We ask that you comment on the following situations:

Situation 1:

Our concern is with Corporation A. Even though payment for services are received from another Pennsylvania corporation, the employees of Corporation A have performed the income generating services in various states. We believe that nexus exists with those various states with regard to income generated by services performed in those states by the employees of Corporation A. For the purpose of determining state income tax liability in your state, would you provide us with your determination regarding this situation.

Situation 2:

All information is the same as above, except that in some instances, Corporation A has had to hire subcontractors to do the on site training because enough employees were not available for some assignments. With regard to income generated in the various states by the subcontractors, does nexus exist for Corporation A in your state? If so, are the subcontractor fees to be included in the payroll factor for apportionment purposes?

Please advise us as to the income tax liability regarding both situation 1 and 2. Also, if nexus exists in these situations for income tax purposes, does it exist for any other tax liability in your state?

Whether a taxpayer has nexus with Illinois is a fact-specific determination that can only be made in the context of an audit in which a Department auditor would have access to all relevant facts. Therefore, we cannot issue a letter ruling concerning whether your client has nexus with Illinois. Further, the Department does not issue private letter rulings where the taxpayer has not been identified in the ruling request. However, we can provide you with the following general information concerning income tax nexus.

Under Section 201 of the Illinois Income Tax Act ("IITA"), a tax measured by net income is imposed on every corporation for the privilege of earning or receiving income in this State. Pursuant to P.L. 86-272, an out-of-state corporation is not subject to the Illinois income tax if its activities within Illinois consist of the mere solicitation of orders for items of tangible personal property and: (i) the orders are accepted or rejected outside of Illinois; and (ii) if the orders are accepted, such orders are filled from inventories maintained outside of Illinois and are shipped or delivered to Illinois customers from those inventories. Since Corporation A provides services, it will not be afforded the limited protection from taxation provided by P.L. 86-272.

Situation 1

In general, an out-of-state corporation will establish nexus with the State if any of its business or non-business income is apportionable or allocable to Illinois under IITA Sections 301 through 304. Based on the information in your letter, it does not appear that non-business income is an issue. An out-of-state corporation would apportion its business income to Illinois pursuant to a three-factor formula based on the corporation's Illinois property, payroll and sales (double-weighted) versus the corporation's property, payroll and sales everywhere. IITA Section 304. Pursuant to IITA Section 304(a)(3)(C), a corporation's sales are in Illinois if: (i) the income-producing activity is

performed in this State; or (ii) the income-producing activity is performed both within and without this State and a greater proportion of the income-producing activity is performed within this State than without this State, based on performance costs. The term "income-producing activity" refers to "...the transactions and activity directly engaged in by the person in the regular course of its trade or business for the ultimate purpose of obtaining gains or profit." 86 Ill. Adm. Code Section 100.3370(d)(3). Therefore, it appears that Corporation A will establish nexus with Illinois if providing computer software training is its income-producing activity and such activity, in whole or in part, is performed within Illinois.

Situation 2

When an out-of-state corporation uses "subcontractors" to provide services to customers, the corporation must determine whether such individuals are "employees" or "independent contractors". Whether an individual is an "employee" or an "independent contractor" is a factual determination that can be made only after a review of all relevant facts and circumstances. Based on the limited information in your letter, the Department cannot determine whether the individuals referred to as "subcontractors" are "employees" or "independent contractors". Neither term is defined in the IITA. Pursuant to IITA Section 102, terms not defined in that Act are given the meaning applicable to such terms in the Internal Revenue Code ("IRC"), except where the contexts in which such terms are used would require otherwise. If the individuals referred to as "subcontractors" come within the meaning of the term "employee" as defined in IRC Section 3401(c) and Treasury Regulation Section 31.3401(c)-1, Corporation A would probably establish nexus with Illinois. Accordingly, all income generated by such individuals would be included in Corporation A's business income that would be apportioned to Illinois under IITA Section 304. Further, any remuneration for services performed by such individuals would be "compensation", and therefore would be included in Corporation A's payroll factor, provided that such compensation was paid in Illinois. The factors used to determine whether compensation is "paid" in Illinois are set forth in IITA Section 304(a)(2)(B) and 86 Ill. Adm. Code Section 100.7010.

The individuals that you referred to as "subcontractors" in your letter may establish nexus in Illinois for Corporation A in Illinois even if they are considered "independent contractors". See Scripto, Inc. v. Carson, 362 U.S. 207, 80 S.Ct. 619, 4 L.Ed.2d 660 (1960) (activities of an independent contractor are sufficient to establish nexus for a taxpayer with the state in which such activities are performed.). These individuals act as agents for Corporation A. You stated in your letter that the "subcontractors" provide software training to Corporation A's customers when Corporation A does not have enough employees to provide such training. In such capacity, the "subcontractors" provide the same services as Corporation A's employees. Therefore, the activities of the subcontractors, acting as Corporation A's agents, would probably establish nexus with Illinois for Corporation A. However, if nexus is established in this situation, the income derived from services performed by the subcontractors would not be included in Corporation A's sales factor. 86 Ill. Adm. Code Section 100.3370(d)(3)(A). Similarly, remunerations paid to the subcontractors would not be included in Corporation A's payroll factor. Further, the independent contractors would be subject to taxation in Illinois if the remunerations they receive from Corporation A are considered compensation "paid" in Illinois. See IITA Section 304(a)(2)(B).

Corporation A may be subject to the Illinois franchise tax if it is required to be authorized to do business in Illinois. The Illinois Secretary of State's office administers the franchise tax and determines whether out-of-state corporations are subject to such tax. You can contact the Secretary of State at the following address:

The Honorable George Ryan
Secretary of State
Business Services Department
Howlett Building, Room 328
Springfield, IL 62756

You may contact the Department if you have additional questions regarding this matter.

Sincerely,

Rickey A. Walton
Staff Attorney (Income Tax)